LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
SEP 21 1966
JOHN F. DAVIS, CLERK

IN THE Supreme Court of the United States

October Term, 1966

No. 580

POLY INDUSTRIES, INC.,

Petitioner,

vs.

DON S. MOZLEY, *et al.*,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

GEORGE M. TREISTER,
639 South Spring Street,
Los Angeles, Calif. 90014,
Attorney for Petitioner.

QUITTNER, STUTMAN, TREISTER & GLATT,
FRANCIS F. QUITTNER,
JACK STUTMAN,
HERMAN L. GLATT,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

SUBJECT INDEX

	Page
Citations to opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	6
Conclusion	11

INDEX TO APPENDICES

Appendix A. Bankruptcy Act, Sec. 17a(1), 11 11 U.S.C., Sec. 35a(1)	1
Appendix B. Memorandum Opinion Re Petition for Rehearing	3
Opinion of United States Court of Appeals for the Ninth Circuit	4
Appendix C. Opinion of The Supreme Court of the United States	14

TABLE OF AUTHORITIES CITED

Cases	Page
Bruning v. United States, 376 U.S. 358	6, 7, 8
City of Richmond v. Bird, 249 U.S. 174	6
National Foundry Co. of New York v. Director of Internal Revenue, 229 F. 2d 149	7, 8
New York v. Saper, 336 U.S. 328	7
Simonson v. Granquist, 369 U.S. 38	7, 10
Sword Line, Inc. v. Industrial Commissioner of State of New York, 212 F. 2d 865, cert. den., 384 U.S. 830	7, 8
United States v. Edens, 342 U.S. 912	7
United States v. General Engineering and Manufacturing Company, 342 U.S. 912	7

Statutes

Bankruptcy Act, Sec. 17	6, 8
Bankruptcy Act, Sec. 17a(1)	2
Bankruptcy Act, Sec. 24c	2
Bankruptcy Act, Sec. 57j	2, 4, 7, 8
Bankruptcy Act, Sec. 64a(4)	2, 6, 7, 8, 9, 10
Bankruptcy Act, Sec. 67b	2, 6, 9
Bankruptcy Act, Sec. 70c	10
Bankruptcy Act, Sec. 371	2, 8
California Revenue & Taxation Code, Sec. 134	9
California Revenue & Taxation Code, Secs. 2186-2195	9
California Revenue & Taxation Code, Sec. 2189	9

Page

California Revenue & Taxation Code, Sec. 2189.3 9

California Revenue & Taxation Code, Sec. 2191.3 ..... 4, 9

California Revenue & Taxation Code, Sec. 2191.4 ..... 5, 9, 10

California Revenue & Taxation Code, Sec. 2191.5 10

United States Code, Title 11, Sec. 35a(1) 2

United States Code, Title 11, Sec. 47c 2

United States Code, Title 11, Sec. 93j 2

United States Code, Title 11, Sec. 104a(4) 2

United States Code, Title 11, Sec. 107b 2

United States Code, Title 11, Sec. 771 2

United States Code, Title 28, Sec. 1254(1) 1

IN THE

Supreme Court of the United States

October Term, 1966
No. .....

POLY INDUSTRIES, INC.,

Petitioner,

vs.

DON S. MOZLEY, *et al.*,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Poly Industries, Inc. prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on June 17, 1966.

Citations to Opinions Below.

The memorandum opinion of the referee in bankruptcy [R. 107] is unreported and is printed in Appendix B hereto, *infra,* p. 3. The District Court did not write an opinion. The opinion of the Court of Appeals, printed in Appendix B hereto, *infra,* p. 3, is reported in 362 F. 2d 453.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 17, 1966 [R. 178]. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1)

and Section 24e of the Bankruptcy Act, 11 U.S.C., Section 47c.

Questions Presented.

1. Whether a tax claim which has been denied participation in the assets of a Chapter XI debtor estate by final order of the referee on the authority of Sections 64a(4) and 57j of the Bankruptcy Act may be collected from the rehabilitated Chapter XI debtor following confirmation of the debtor's plan of arrangement, particularly where by the nature of the plan of arrangement the opportunity for the debtor's unsecured creditors to achieve significant reimbursement on their claims is dependent upon the ability of the rehabilitated debtor to operate its business successfully.

2. Whether such tax claim, having no lien status, inchoate or otherwise, at the commencement of the Chapter XI proceeding, may, through action taken by the taxing agency subsequent to the consummation of the debtor's plan of arrangement, be converted retroactively into a lien claim so as to nullify the referee's final order and escape the limiting provisions of Section 64a(4) of the Bankruptcy Act.

Statutes Involved.

The statutory provisions involved are Sections 17a (1), 57j, 64a(4), 67b, and 371 of the Bankruptcy Act, 11 U.S.C., Sections 35a(1), 93j, 104a(4), 107b, and 771. They are printed in Appendix A, *infra*, pp. 1-2.

Statement.

In March, 1962 and March, 1963, Ador Corporation, Petitioner's wholly owned subsidiary [R. 26], became indebted to Respondent for unsecured personal

property taxes owing to the County of Orange, State of California, in the respective amounts of $25,787.55 and $18,056.40. [R. 51, 53]. Petitioner filed its proceeding under Chapter XI of the Bankruptcy Act on January 31, 1963. [R. 170]. On June 7, 1963 Ador Corporation instituted proceedings under Chapter XI. [R. 57].

Ador Corporation and Petitioner filed a consolidated plan of arrangement which was confirmed by order of the referee in bankruptcy entered on July 18, 1963. [R. 2-50]. As part of the confirmed, consolidated plan of arrangement, all creditors of Ador Corporation became creditors of Petitioner. Except for those creditors having claims of $100.00 and under, all unsecured creditors received one share of the capital stock of Petitioner for each one dollar of indebtedness owing. In that manner, the creditors of the two corporations came to own 80% of the issued and outstanding stock of Petitioner. Apart from the stock so issued, the creditors received no other consideration by way of reduction or satisfaction of their claims. [R. 111].

Certain of the funds required for the deposit to be made in aid of the confirmation of the consolidated plan of arrangement were obtained through sale by Petitioner of the capital stock of Ador Corporation and other of Petitioner's assets to a third party, pursuant to an agreement which required Petitioner to hold Ador Corporation harmless from various liabilities, including those obligations for the personal property taxes owing to Respondent on behalf of the County of Orange. [R. 110]. That portion of Petitioner's hold harmless agreement relating to the Orange County tax claims was supplemented by Petitioner's deposit of $50,000.00

of its funds in trust. The tax claims of the County of Orange, to the extent found payable, were to be paid from the deposit with the balance to be remitted to Petitioner. [R. 171].

Following confirmation of the consolidated plan of arrangement on July 18, 1963, Ador Corporation and Petitioner were revested with their assets. [R. 16]. On July 30, 1963, Respondent County Tax Collector filed in the Chapter XI proceedings his unsecured claims numbered 168 and 169 for the 1962 and 1963 personal property tax obligations of Ador Corporation. [R. 51-54]. Included in claim 168 was the sum of $2063.00 in penalties. [R. 51]. Following hearing on objections to the two claims, the referee allowed them in the combined amount of $350.00 only. [R. 60]. This order, dated January 2, 1964, was based primarily upon Section 64a(4) of the Bankruptcy Act; to the extent of the $2063.00 in penalties included in claim 168, the disallowance was also predicated upon Section 57j of the Act. [R. 110]. No timely review being taken, the referee's order of January 2, 1964 became final ten days, later. [R. 110].

On April 2, 1964, a date subsequent to both the confirmation of the consolidated plan of arrangement of Ador Corporation and Petitioner, and the revesting of assets in the two corporations, Respondent recorded certificates of delinquency of personal property tax against Ador Corporation; these certificates related to the same obligations asserted in claims 168 and 169. [R. 98, 99]. By California statute,[1] recordation of a certifi-

[1]California Revenue & Taxation Code Section 2191.3 provides: "Where there is a tax . . . on personal property not secured by a lien on any real property and such tax has be-

cate of delinquency of personal property tax creates a lien upon all the taxpayer's personal and real property within the county.

On Petitioner's application, the referee on April 24, 1964, ordered that the County of Orange be paid the sum of $350.00 only on its claims 168 and 169, and enjoined Respondent from attempting to collect the tax obligations from Ador Corporation. [R. 71-74].

Respondent subsequently petitioned the referee to vacate the order of April 24, 1964. [R. 79-81]. In reply, Petitioner requested a broadening of the injunction of April 24, 1964 to compel Respondent to withdraw or to satisfy or record the certificates of delinquency. [R. 101-104].

By order of July 22, 1964, the referee vacated his previous order and injunction of April 24, 1964 and denied Petitioner the additional injunctive relief sought. [R. 112]. This order of July 22, 1964 was affirmed by the District Court on December 14, 1964 [R. 147, 148], and by the Court of Appeals on June 17, 1966. [R. 170-178].

The decision of the Court of Appeals is predicated on two theories: First, that the claims of the Tax Collector of Orange County survived confirmation of the debtor's plan of arrangement by virtue of Section

---

come delinquent, the tax collector . . . may file for record in the office of the county recorder a certificate specifying the amount of the personal property tax due, interest and penalties due . . .".

California Revenue & Taxation Code Section 2191.4 further provides: "From the time of filing the certificate for record pursuant to Section 2191.3, the amount required to be paid together with interest and penalty constitutes a lien upon all personal and real property in the county owned by the taxpayer or acquired by him before the lien expires . . .".

17 of the Bankruptcy Act and *Bruning v. United States*, 376 U.S. 358 [R. 173-175];[2] alternatively, that the tax claims were not subject to the provisions of Section 64a(4) of the Bankruptcy Act because they acquired lien status after the date of bankruptcy (citing this Court's decision in *City of Richmond v. Bird*, 249 U.S. 174 and Section 67b of the Bankruptcy Act).

Reasons for Granting the Writ.

1. The decision of the Court of Appeals has misapplied, misconstrued and misconceived this Court's opinion in *Bruning v. United States, supra.* In *Bruning*, a straight bankruptcy case, this Court held that post-bankruptcy interest on a tax claim, although not allowable out of the estate, nevertheless survived the discharge of the bankrupt. In support of its holding, the Court reasoned that pre-bankruptcy creditors would not be prejudiced by the collection of such interest from the discharged bankrupt after bankruptcy.

The Court of Appeals applied the reasoning of *Bruning* to Chapter XI proceedings and developed therefrom the concept that all disallowed or limited penalties and taxes remain a continuing obligation of a rehabilitated Chapter XI debtor after confirmation. The Court of Appeals gave no legal effect to the fact that the present taxes and penalties were denied participation in the debtor estate by final order of the referee. Nor did the decision below recognize the fact that post-confirmation collection of such taxes and penalties would adversely affect the ability of the Chapter XI creditors to achieve significant reimbursement on their

[2]For convenience, the opinion of this Court in *Bruning* is set forth in Appendix C, *infra*, at p. 14.

claims. This extension of *Bruning* ignores this Court's concern for the debtor's unsecured creditors, jeopardizes the success of all Chapter XI proceedings, and is inconsistent with the purpose of Sections 64a(4) and 57j of the Bankruptcy Act by permitting the taxing agency to collect indirectly at the expense of creditors claims which the Act disallows or limits.

2. The decision of the Court of Appeals appears to be inconsistent with the decisions of this Court in *New York v. Saper*, 336 U.S. 328; *United States v. General Engineering and Manufacturing Company*, 342 U.S. 912; *United States v. Edens*, 342 U.S. 912; and *Simonson v. Granquist*, 369 U.S. 38. The first three named decisions held that post-bankruptcy interest on tax claims could not be collected from a bankrupt estate (*Saper*), the estate of a rehabilitated Chapter XI debtor (*General Engineering*), and the estate of a reorganized Chapter X debtor (*Edens*). *Simonson* held that Section 57j of the Bankruptcy Act disallowed tax penalties even though they had attained lien status before bankruptcy. The common thread running through each of these decisions is the concept that, save where expressly so provided by the Bankruptcy Act, tax claims should be accorded no particular favoritism at the expense of general creditors.

3. The decision of the Court of Appeals appears to be in direct conflict with decisions of the Court of Appeals for the Second Circuit in two Chapter XI cases, *Sword Line, Inc. v. Industrial Commissioner of State of New York*, 212 F. 2d 865, cert. den., 384 U.S. 830, and *National Foundry Co. of New York v. Director of Internal Revenue*, 229 F. 2d 149. The *Sword Line* and *National Foundry* cases held that post-petition interest

on tax claims was not recoverable from rehabilitated Chapter XI debtors, Sections 371 and 17 of the Bankruptcy Act notwithstanding. *National Foundry* further held that post-petition tax penalties could not be recovered from the rehabilitated Chapter XI debtor. Neither *Sword Line* nor *National Foundry* was discussed by this Court in its opinion in *Bruning v. United States, supra*, a fact which suggests that *Bruning* was intended to apply to straight bankruptcy only.

4. Of great importance in the administration of the Bankruptcy Act are the following holdings made either squarely or inferentially in the opinion of the Court of Appeals:

A. Pre-bankruptcy penalty claims, disallowed pursuant to Section 57j of the Bankruptcy Act, survive the confirmation of a plan of arrangement and remain a continuing liability of the rehabilitated Chapter XI debtor.

B. Disallowed pre-bankruptcy penalty claims remain a continuing liability of a discharged bankrupt.

C. Property taxes, although allowable under Section 64a(4) of the Act only to the extent of the interest of the debtor estate in the taxed property, nevertheless survive the confirmation of a plan of arrangement without any limitation, and thus remain a continuing liability of the rehabilitated Chapter XI debtor.

D. Property taxes limited in payment by Section 64a(4) of the Bankruptcy Act survive the discharge of a bankrupt in their entirety.

E. Post-petition interest on tax claims survives the confirmation of a plan of arrangement and remains a continuing liability of the rehabilitated Chapter XI debtor.

In view of the frequency with which such questions arise in the administration of Chapter XI and straight bankruptcy cases and the importance of the issues, the governing rules should be authoritatively established by this Court.

5. The Court of Appeals erred in holding that by recording certificates of delinquency subsequent to the filing of the Chapter XI proceeding of Ador Corporation, the County Tax Collector became a lien creditor retroactive to the inception of the Chapter XI proceeding and thereby escaped the limiting provisions of Section 64a(4) of the Bankruptcy Act. That the Court of Appeals erred is reflected by the following:

A. Section 67b of the Bankruptcy Act, which permits *perfection* of certain types of liens subsequent to bankruptcy, applies only to liens which have *arisen* prior to bankruptcy. The tax claims of the County of Orange had no lien status, inchoate or otherwise, on the date of the filing of Ador Corporation's Chapter XI proceeding.[3]

---

[3]Sections 2186 through 2195 of the California Revenue & Taxation Code deal with the effect of taxes levied by a county against personal and other property of the taxpayer. Upon their levy, taxes assessed against personal property become liens only upon real estate owned by the tax debtor within the taxing county. Cal. Rev. & T. C., Sections 2189, 2189.3. Where the tax debtor owns no real property within the taxing county (as was true of the Ador Corporation at the commencement of its Chapter XI proceeding), the tax assessed is unsecured as is the personal property on which the tax is levied. Cal. Rev. & T. C., Section 134.

Sections 2191.3 and 2191.4 of the California Revenue & Taxation Code creating and giving legal effect to the certificate of delinquency are designed to aid in the collection of delinquent, unsecured personal property taxes. It is only upon the filing of the certificate of delinquency that a lien is created.

(This footnote is continued on the next page)

B. If, *arguendo,* the County of Orange had an inchoate lien at the inception of the Chapter XI proceeding, the County failed to raise that issue before the referee in the proceeding brought to limit payment of its claims under Section 64a(4) of the Bankruptcy Act.

C. Assuming again, *arguendo,* that the County of Orange had an inchoate lien at the inception of the Chapter XI proceeding, the perfection of that lien through filing of certificates of delinquency did not occur until after the confirmation of the plan of arrangement and the revesting of assets in the rehabilitated debtor.

D. The Court of Appeals gave no legal effect to the fact that claim 168 of the Orange County Tax Collector included $2063.00 in penalties. If the Court of Appeals intended its holding to mean that the penalty portion of Respondent's claim escaped disallowance by virtue of a lien status, such holding would directly conflict with the decision of this Court in *Simonson v. Granquist, supra.*

Ador Corporation filed its Chapter XI proceeding on June 7, 1963. Respondent did not record his certificates of delinquency until April 2, 1964. Accordingly, the hypothetical lien provided for in Section 70c of the Bankruptcy Act, which arises as of the filing date, predated Respondent's liens. Application of the Section 70c lien to Section 2191.5 of the California Revenue & Taxation Code demonstrates a further error in the decision of the Court of Appeals. Section 2191.5 reads as follows: "Section 2191.4 does not give the county a preference over any other lien which attached prior to the date when the certificate of delinquency of personal property tax was recorded . . .".

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE M. TREISTER,
Attorney for Petitioner.

QUITTNER, STUTMAN, TREISTER & GLATT,
FRANCIS F. QUITTNER,
JACK STUTMAN,
HERMAN L. GLATT,
Of Counsel.

APPENDIX A.

Bankruptcy Act, Section 17a(1), 11 U.S.C., Sec. 35a(1):

"A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality . . ."

Bankruptcy Act, Section 57j, 11 U.S.C., Sec. 93j:

"Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

Bankruptcy Act, Section 64a(4), 11 U.S.C., Sec. 104a(4):

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court . . ."

Bankruptcy Act, Section 67b, 11 U.S.C., Sec. 107b:

"The provisions of section 60 of this Act to the contrary notwithstanding, . . . statutory liens for taxes and debts owing to . . . any State or any subdivision thereof, created or recognized by the laws . . . of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws . . ."

Bankruptcy Act, Section 371, 11 U.S.C. Sec. 771:

"The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, but excluding such debts as, under section 17 of this Act, are not dischargeable."

APPENDIX B.

Memorandum Opinion Re Petition for Rehearing.

United States District Court, Southern District of California. Central Division.

In the Matter of Poly Industries, Inc., a California corporation. Debtor. No. 150,722-HW.

The court after mature deliberation has concluded that although the factual situation in the present case is different, that the principle of law enunciated in the case of Brunning v. United States (3-23-64) ....U.S. ...., is applicable. The injunction against the County of Orange from enforcing collection of its tax claims issued April 24, 1964, will be vacated.

Counsel for Orange County will prepare, serve and submit an appropriate order.

Dated: June 11, 1964.

/s/ JOSEPH J. RIFKIND,
Joseph J. Rifkind,
Referee in Bankruptcy

Opinion of United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Poly Industries, Inc., Appellant, vs. Don S. Mozley, et al., Appellees. No. 19,972.

[June 17, 1966]

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Barnes and Merrill, Circuit Judges; and Taylor, District Judge.

Barnes, Circuit Judge:

This is an appeal from an order of the district court which affirmed an order of a referee in bankruptcy. The district court had jurisdiction pursuant to 11 U.S.C. §11. This court has jurisdiction pursuant to 11 U.S.C. §47.

Appellee Don S. Mozley is the Tax Collector of the County of Orange, State of California. Appellant Poly Industries, Inc., a corporation, owned a subsidiary known as Ador Corporation which was subject to county taxes in Orange County. In March 1962 and 1963, Mozley assessed personal property taxes against the Ador Corporation. These tax obligations had not been paid at the time these proceedings were instituted.

On January 31, 1963 Poly Industries initiated a Chapter XI proceeding under the Bankruptcy Act. On June 7, 1963 Ador Corporation initiated Chapter XI proceedings also. Poly Industries proposed a consolidated arrangement for itself and Ador Corporation pursuant to Chapter XI. Under the terms of the arrangement, creditors of Ador became creditors of Poly and

took Poly stock in satisfaction of their claims. In order to satisfy the claims of priority creditors who could not be forced to take stock in Poly in lieu of their claims, Poly sold some of its real property and the stock of Ador to a Mr. Carl Reinhard for a large cash payment. As part of the sale to Reinhard, Poly agreed to hold Ador Corporation (Reinhard) harmless from various types of claims arising prior to the arrangement. One such anticipated claim was the tax obligation of Ador to Orange County, and part of the hold-harmless agreement was that Poly would deposit $50,000 of its money in a trust account with the understanding that the money would be used to pay any tax claims found to be owing and the remainder of the money would be returned to Poly. This consolidated arrangement of Ador and Poly was confirmed by the referee in bankruptcy on July 18, 1963.

On July 30, 1963 appellee Mozley filed claims 168 and 169 in the arrangement proceedings, representing the unpaid 1962-1963 taxes of Ador, together with interest and penalties. These claims aggregated in excess of $46,000. Appellant filed objections to the tax claims of appellee and a hearing was set and continued on three occasions. The hearing was finally held on December 20, 1963 without Mozley or his counsel putting in an appearance. In his findings and conclusions filed on January 2, 1964, the referee sustained appellant's objection to the tax claims on the basis of sections 57j and 64a(4) of the Bankruptcy Act, 11 U.S.C. §§93j, 104a(4). Section 57j disallows debts owing to the United States or the States which are penalties or forfeitures except for the amount of actual loss or cost to the taxing entity arising from the transaction from

which the penalty arose. Section 64a(4) provides that although tax claims shall have a priority over payment to creditors, "no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court. . . ." The referee found that at the time the personal property taxes were assessed, Ador's assets were all encumbered to the hilt and that Ador actually had an interest in none of the assets which it possessed with the exception of $350 in cash which was on hand on June 7, 1963 when Ador petitioned for a Chapter XI arrangement. The referee allowed the tax claims of appellee to the extent of the unencumbered $350, and disallowed the remainder of the claims pursuant to sections 57j and 64a(4) of the Bankruptcy Act.

Following the referee's January 2, 1964 decision, Poly petitioned the referee for an order directing it to pay Mozley the $350, to return the balance of the $50,000 deposit to Poly, and to permanently enjoin Mozley from ever attempting to collect his tax claims in these or other proceedings. Hearing was had on this petition, at which Mozley and his counsel were again absent. On April 24, 1964 the referee granted Poly's petition.

In the meantime, Mozley had on April 2, 1964 recorded two certificates of delinquency relating to the tax claims against Ador. Upon their recordation the certificates became a lien upon the assets of the reorganized Ador Corporation. Prior to the recordation the tax claims had the standing of a *priority* under the Bankruptcy Act; after the recordation they became a *lien*, with a higher standing, under the Bankruptcy Act.

Armed with his recorded statutory liens, and alleging excusable neglect in not having appeared to oppose Poly's petition for injunction, Mozley petitioned the referee to vacate his order of April 24, 1964 and the injunction contained in that order. Poly responded with a petition to the referee to broaden the injunction he had granted in the April 24, 1964 order so as to compel Mozley to withdraw his lien or to file satisfactions of the recorded delinquency certificates. The referee held hearings on the petition and counter-petition and on July 22, 1964 vacated his order and injunction of April 24, 1964, and denied Poly the additional injunctive relief which it sought. In reaching this decision the referee relied upon section 17 of the Bankruptcy Act, 11 U.S.C. §35, and the case of *Bruning v. United States*, 376 U.S. 358 (1964) to find that the recorded tax liens were nondischargeable debts and that it would be an abuse of his discretion to enjoin Mozley from collecting a nondischargeable debt. The effect of this decision was to permit Mozley to satisfy his tax claim in full out of the $50,000 deposit made pursuant to the hold-harmless agreement between reorganized Ador (Reinhard) and Poly.

Poly petitioned the district court for review of the July 22, 1964 order of the referee. The district court affirmed the July 22, 1964 order and this appeal by Poly followed.

We affirm the judgment of the district court. Affirmance is compelled in the circumstances of this case for two reasons, each of which is individually sufficient to require affirmance.

I. The Injunction of April 24, 1964.

In his order of January 2, 1964 and in his order and injunction of April 24, 1964, the referee in bankruptcy relied exclusively upon sections 57j and 64a(4) of the Bankruptcy Act in disallowing all but $350 of appellee Mozley's tax claims and in enjoining him from ever attempting to collect the taxes. It was not until Mozley had recorded his tax claims and thus converted them into statutory liens that the referee considered section 17 of the Bankruptcy Act and the case of *Bruning v. United States, supra,* and found that the recorded tax liens were nondischargeable debts the collection of which could not be enjoined. We believe that the referee fell into error when he failed to apply section 17 of the Bankruptcy Act and the reasoning of *Bruning v. United States, supra,* to the tax claims of appellee even before those tax claims were recorded and thereby converted into liens. We believe that the application of such reasoning would have revealed that the tax claims were nondischargeable debts even before they acquired lien status, and their collection should therefore not have been enjoined, even prior to their recordation and conversion into statutory liens.

Section 17a(1) of the Bankruptcy Act, 11 U.S.C. §35a(1), provides in pertinent part that "(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; . . ." Section 371 of the Bankruptcy Act, 11 U.S.C. §771 (which is one of the provisions of the Chapter XI arrangement provisions) provides that "The confirmation of an arrangement shall discharge

a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, but excluding such debts as, under section 17 of this act, are not dischargeable." The effect of section 17 is to make county taxes such as those involved in this case nondischargeable in bankruptcy, and to leave the bankrupt still liable for the taxes even after he has received a discharge in bankruptcy. The effect of section 371 is to specifically carry section 17 into the Chapter XI arrangement proceedings and in effect to provide that while the confirmation of a Chapter XI arrangement acts the same as a discharge in bankruptcy as to most debts and liabilities, it does not act as a discharge from liability for county taxes which are made nondischargeable by section 17. See 9 Collier, Bankruptcy §§9.25[6], 9.32[9].

The rule that tax claims are nondischargeable debts which survive bankruptcy or arrangement proceedings was recognized in the recent Supreme Court decision in *Bruning v. United States, supra.* Although the *Bruning* decision deals primarily with liability for interest on tax claims, the Court had occasion to note the continuing liability of the bankrupt for tax claims not satisfied out of the bankrupt estate:

> "It is undisputed that, under §17, petitioner remained personally liable after his discharge for that part of the principal amount of the tax debt and pre-petition interest not satisfied out of the bankruptcy estate.
>
> * * *
>
> "As the Court of Appeals noted, §17 is not a compassionate section for debtors. Rather, it dem-

> onstrates congressional judgment that certain problems—e.g., those of financing government—override the value of giving the debtor a wholly fresh start. Congress clearly intended that personal liability for unpaid tax debts survive bankruptcy." 376 U.S. at 360-1.

While a tax claim not made into a lien might be subject to a limitation on its payment during the course of bankruptcy or arrangement proceedings by section 64a(4), the fact that such a limitation could be imposed would not mean that the rest of the claim ceased to exist. On the contrary, the effect of limiting the amount of the claim allowed through application of section 64a(4) would seem to be that the remainder of the claim continues in existence and may be enforced against the bankrupt or, as here, against the reorganized owner of the property, even after a discharge. It is because the tax claims are nondischargeable and continue in existence after the bankruptcy or arrangement proceedings have been completed that counsel have not been able to cite any cases where collection of taxes was permanently enjoined. We thus conclude that it was error for the referee to issue his April 24, 1964 injunction restraining the collection of a nondischargeable debt. That error was cured when the referee lifted the injunction in his decision of July 22, 1964.

II. The Tax Liens of April 2, 1964.

The second reason that the order of the district court must be affirmed springs from appellee Mozley's recordation of the certificates of delinquency on April 2, 1964. By recording, the certificates of tax delinquency became tax liens, and tax liens are not subject to the limitation on their payment during the pendency of

bankruptcy or arrangement proceedings that mere tax priorities are subject to under section 64a(4) of the Bankruptcy Act. This position is recognized, and supporting authority cited, in 3 Collier, Bankruptcy §64.-403:

> "The principle expounded by the Supreme Court in *City of Richmond v. Bird,* and the cases which concur therewith—that §64 does not apply to tax claims which are secured by valid liens—is apparently broad enough to limit *all* the provisions of §64a(4) to unsecured tax claims alone. Nevertheless, there has been some authority for the proposition that the provision of §64a(4) which gives the bankruptcy court the power to determine the legality and amount of tax claims is meant to include taxes secured by valid liens as well, and that the bankruptcy court can re-examine the assessment of taxes even after they have become perfected liens. This particular doctrine itself must be re-examined, however, in view of the recent Supreme Court decision in *Arkansas Corporation Commission v. Thompson,* which limited the bankruptcy court's general power to determine and revise the assessment of taxes. It is settled, however, that the proviso of §64a(4) limiting the payment of a tax assessed against property of the bankrupt to the value of the interest of the estate therein does not affect the recognition of valid liens.
>
> "Although, in general, the priority status of a claim is fixed as of the date of filing the petition, tax claims which are entitled only to priority under §64a(4) may subsequently become perfected liens, even after an adjudication. It has also been de-

cided that a tax claim which would have been entitled to be secured as a lien, but which was not perfected in accordance with the statutory procedure, may still be paid as a tax claim under §64a (4)." (Footnotes omitted.) Cf. also 3 Collier, Bankruptcy §64.401[2].

Moreover, it has been recognized that a lien does not lose its preferred standing by reason of the fact that it is not perfected until after the commencement of bankruptcy or Chapter XI proceedings. Section 67b of the Bankruptcy Act, 11 U.S.C. §107b, specifically authorizes such perfection, and Collier supports the practice with text and authority. 4 Collier, Bankruptcy §67.20[8]:

> "The first sentence of subdivision b states clearly that statutory liens
>
> 'may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him.'
>
> Certainly this provision is applicable where proceedings are begun under Chapter X, XI, XII, XIII and are subsequently followed by adjudication of the debtor as a bankrupt. But a reasonable interpretation would also give effect to the quoted provisions in Chapter X, XI, XII, or XIII proceedings that are successfully terminated thereunder and hence do not end in bankruptcy, whether (1) the proceeding is begun in bankruptcy and is followed by a successful Chapter X, XI, XII or XIII proceeding, or (2) is originally begun and successfully ends as a Chapter X, XI, XII or

XIII proceeding. Moreover the subdivision now clearly applies in railroad reorganization proceedings under §77.

"The second sentence of subdivision b authorizes the perfection of statutory liens that arise but are not perfected ~~before~~ *bankruptcy* and makes no reference to the perfection of liens after the filing of a petition under the debtor relief chapters. Since, however, 'bankruptcy' when used with reference to time means 'the date when the petition was filed,' and 'petition' means a 'document initiating a proceeding under this Act,' the second sentence appears to have as broad an application as the first sentence of subdivision b. There would seem to be no fundamental policy or principle peculiar to reorganization or arrangement proceedings which would be nullified by permitting perfection of inchoate liens after their commencement." (Footnotes omitted.)

While raising various suggestions as to the impropriety of appellee Mozley's having recorded the tax delinquency certificates and thus converted the tax priorities into tax liens, appellant has been unable to cite any authority for the position that this conduct was not permissible. In light of the favored status of statutory liens and of the protection which taxes are accorded in any event by sections 17 and 371, and in the absence of any showing that appellee acted beyond methods specifically provided under the Bankruptcy Act, we cannot conclude that the district court or the referee erred in granting and affirming the order of July 22, 1964.

The order of the district court affirming the decision of the referee is *affirmed*.

APPENDIX C.

Paul F. Bruning, Petitioner, v. United States. No. 423. Argued March 3, 1964. Decided March 23, 1964.

Ernest R. Mortenson, Pasadena, Cal., for petitioner.

Philip B. Heymann, Washington, D.C., for respondent.

Mr. Chief Justice Warren delivered the opinion of the Court.

The issue presented in this case is whether the United States is entitled to recover, out of assets acquired by a debtor after his adjudication of bankruptcy, post-petition interest on a tax assessment which (under § 17 of the Federal Bankruptcy Act, 30 Stat. 544, 550, as amended, 11 U.S.C. § 35) was not discharged in the bankruptcy proceedings. The essential facts are not in dispute. Petitioner incurred withholding and federal insurance contributions taxes during the fourth quarter of 1951 but failed to pay those taxes when due. In March 1952, an assessment of those taxes was made against petitioner. On July 6, 1953, petitioner filed a voluntary petition in bankruptcy and was adjudicated a bankrupt in the Federal District Court for the Western District of Louisiana. The District Director of Internal Revenue filed a claim in the bankruptcy proceedings for the assessed amount owed by petitioner, and the United States received a small distribution out of the assets of the bankruptcy estate. Petitioner was granted a discharge in bankruptcy in October 1953, and the case was closed in June 1954.

In 1957, petitioner filed claims for refund of income taxes paid for the years 1953 and 1954, which resulted in his being allowed a credit for income taxes and interest in respect of those years. On March 7,

1958, the Director of Internal Revenue applied the entire 1953 credit and part of the 1954 credit[1] to the balance of the assessment of the withholding and F.I.C.A. taxes owed for 1951, plus interest to date—including interest which had accrued during the period between the filing of petitioner's petition in bankruptcy (July 6, 1953) and the date of payment (March 7, 1958). This post-petition interest, which totals about $795, is the subject of the present controversy. Petitioner did not question the Director's right to collect from assets acquired by petitioner after bankruptcy the unpaid principal of the tax debt and the pre-petition interest. However, contending that he was not liable for interest accruing on the assessment after his petition in bankruptcy was filed, petitioner brought suit in the Federal District Court for the Southern District of California for refund of that portion of the interest. The District Court held that petitioner's personal liability for post-petition interest on the unpaid taxes was not discharged by the bankruptcy proceedings, and the Court of Appeals for the Ninth Circuit affirmed. Due to an apparent conflict between circuits[2] and the potentially recurring nature of the question involved, we granted certiorari, 375 U.S. 920, 84 S.Ct. 264, 11 L.Ed. 164. We affirm the decision below.

Section 17 of the Federal Bankruptcy Act, 11 U.S.C. § 35, provides in relevant part:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States * * *."

[1]The remainder was distributed to petitioner.

[2]See United States v. Mighell, 273 F.2d 682 (C.A.10th Cir. 1959).

It is undisputed that, under § 17, petitioner remained personally liable after his discharge for that part of the principal amount of the tax debt and pre-petition interest not satisfied out of the bankruptcy estate. The courts below held that, under § 17, petitioner also remained personally liable for post-petition interest on the tax debt, and we find no substantial reason to reverse that holding. Initially, one would assume that Congress, in providing that a certain type of debt should survive bankruptcy proceedings as a personal liability of the debtor, intended personal liability to continue as to the interest on that debt as well as to its principal amount. Thus, it has never been seriously suggested that a creditor whose claim is not provable against the trustee in bankruptcy loses his right to interest in a post-bankruptcy action brought against the debtor personally. In most situations, interest is considered to be the cost of the use of the amounts owing a creditor and an incentive to prompt repayment and, thus, an integral part of a continuing debt. Interest on a tax debt would seem to fit that description. Thus, logic and reason indicate that post-petition interest on a tax claim excepted from discharge by § 17 of the Act should be recoverable in a later action against the debtor personally, and there is no evidence of any congressional intent to the contrary.

Petitioner suggests that the Government might have ignored the bankruptcy proceeding entirely and later brought suit upon its undischarged claim against petitioner personally and collected both principal and interest. But petitioner asserts that once the Government filed a claim in the bankruptcy proceeding, its rights became limited to the recovery of unpaid sums allowed

by the trustee, not including post-petition interest. This argument is based on §6873(a) of the Internal Revenue Code of 1954, which provides:

> "Any portion of a claim for taxes allowed in * * * any proceeding under the bankruptcy Act which is unpaid shall be paid by the taxpayer upon notice and demand from the Secretary or his delegate after the termination of such proceeding."

We find no indication in the wording or history of § 6873(a) that the section was meant to limit the Government's right to continuing interest on an undischarged and unpaid tax liability. Nor is petitioner aided by the now-familiar principle that one main purpose of the Bankruptcy Act is to let the honest debtor begin his financial life anew. As the Court of Appeals noted, § 17 is not a compassionate section for debtors. Rather, it demonstrates congressional judgment that certain problems—*e.g.*, those of financing government—override the value of giving the debtor a wholly fresh start.[3] Congress clearly intended that personal liability for unpaid tax debts survive bankruptcy. The general humanitarian purpose of the Bankruptcy Act provides no reason to believe that Congress had a different intention with regard to personal liability for the interest on such debts.

Finally, petitioner urges that we consider the present case in light of the decision in New York v. Saper, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710. As to claims against the trustee in bankruptcy, the general rule for liquidation of the bankruptcy estate has long been that a creditor will be allowed interest only to

[3]One reason for refusing to make taxes dischargeable is the desire to prevent tax evasion. See 83 Cong.Rec. 9106 (1938).

the date of the petition in bankruptcy. Sexton v. Dreyfus, 219 U.S. 339, 31 S.Ct. 256, 55 L.Ed. 244. In New York v. Saper, supra, this Court held that the general rule applies to claims against the trustee for taxes as well as for other debts. But the instant case concerns the debtor's personal liability for post-petition interest on a debt for taxes which survives bankruptcy to the extent that it is not paid out of the estate. Petitioner asserts that the traditional rule which denies post-petition interest as a claim against the bankruptcy estate also applies to discharge the debtor from personal liability for such interest even if the underlying tax debt is not discharged by § 17. We hold that it does not so apply.

The basic reasons for the rule denying post-petition interest as a claim against the bankruptcy estate are the avoidance of unfairness as between competing creditors and the avoidance of administrative inconvenience.[4]

---

[4]See American Iron & Steel Mfg. Co. v. Seaboard Air Line R. Co., 233 U.S. 261, 266, 34 S.Ct. 502, 504, 58 L.Ed. 949: "And it is true, as held in Tredegar Co. v. Seaboard Air Line R. Co., 105 C.C.A. 501, 4 Cir., 183 Fed. [289] 290, that as a general rule, after property of an insolvent is in *custodia legis* interest thereafter accruing is not allowed on debts payable out of the fund realized by a sale of the property. But that is not because the claims had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. If all claims were of equal dignity and all bore the same rate of interest, from the date of the receivership to the date of final distribution, it would be immaterial whether the dividend was calculated on the basis of the principal alone or of principal and interest combined. But some of the debts might carry a high rate and some a low rate, and hence inequality would result in the payment of interest which accrued during the delay incident to collecting and distributing the funds. As this delay was the act of the law, no one should thereby gain an advantage or suffer a loss. For that and like reasons, in case funds are not sufficient to pay claims of equal dignity, the distribution is

These reasons are inapplicable to an action brought against the debtor personally. In the instant case, collection of post-petition interest cannot inconvenience administration of the bankruptcy estate, cannot delay payment from the estate unduly, and cannot diminish the estate in favor of high interest creditors at the expense of other creditors. In New York v. Saper, supra, the Court found the reasons for the traditional rule applicable and held that post-petition interest on a claim for taxes was not to be allowed against the bankruptcy estate. Here, we find the reasons—and thus the rule—inapplicable, and we hold that post-petition interest on an unpaid tax debt not discharged by § 17 remains, after bankruptcy, a personal liability of the debtor.

Affirmed.

---

made only on the basis of the principal of the debt. But that rule did not prevent the running of interest during the receivership; and if, as a result of good fortune or good management, the estate proved sufficient to discharge the claim in full, interest as well as principal should be paid."

See also Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 164, [67 S.Ct. 237, 240, 91 L.Ed. 162]:

"Accrual of simple interest on unsecured claims in bankruptcy was prohibited in order that the administrative inconvenience of continuous recomputation of interest causing recomputation of claims could be avoided. Moreover, different creditors whose claims bore diverse interest rates or were paid by the bankruptcy court on different dates would suffer neither gain nor loss caused solely by delay." Because the traditional rule rests upon such practical considerations, it has been suggested that:

"The principle that interest stops running from the date of the filing of the petition in bankruptcy should be understood as a rule of liquidation practice rather than as a rule of substantive law." 3 Collier, Bankruptcy (14th ed., 1961) 1858.